

# Utilities Privatization Regulated Considerations



***Presented by Steve Allenby***

***United Financial***

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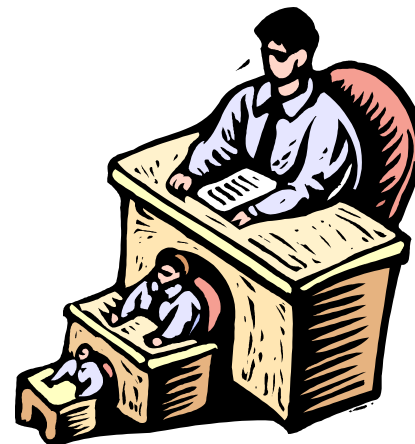


# Doing Business as a ~~Regulated Utility~~

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- **Many Masters**

- Corporate/Risk Management
- Federal and State Regulation
- Accounting
- National Codes and Regulations
- Regional Organizations – ISOs, Electric Reliability Councils, Mutual Aid Agreements



- **Strive for a Highly Reliable System**

- Initial Construction
- Service Restoration

- **Unique Way to Calculate Regulated IOU Prices**



# Calculating Regulated IOU Utility Prices

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- **Cost of Service Pricing**

- Expenses, including the cost of debt, are not marked up
- Only shareholder equity used to buy “Used and Useful Assets that serve customers (Ratebase)” may earn a return
  - The Rate of Return is set by Public Utility Commissions (PUCs)
- PUCs “**allow**” rates that provide utilities with an “**opportunity**” to earn their allowed returns
  - Returns on Ratebase are not guaranteed

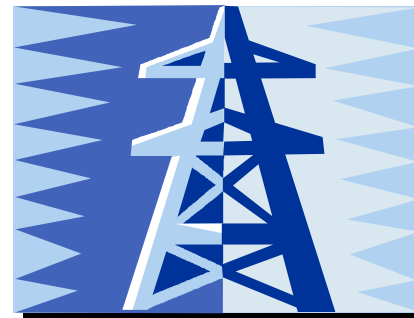
$$\begin{array}{rclcl} \text{Expenses} & + & \text{Return on Ratebase} & = & \text{Utility} \\ \text{Revenue} & & & & \\ \$5 & + & ((.5 \times 8\%) + (.5 \times 12\%) \times \$10) & = & \$6 \\ & & (\text{debt}) & (\text{equity}) & \end{array}$$



# Absorbing a DOD Utility System

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- **Precedent for Purchasing & Absorbing Small Utility Systems**
  - Regulatory
    - No subsidy
    - Charge new customers applicable cost of service rates
    - Special contracts are common
  - Financial/Accounting
    - Ratebase assets
  - Operations
    - Identical treatment
  - Service Restoration
    - Follow utility procedures





# Third Party Financing

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- **System Purchase is not Financed**
  - Credit to government utility bill
- **System Upgrades Might be Financed**
  - Often relatively small
- **Financing Structure - Assign Govt. Payments to Financier in Exchange for Lump Sum Payment**
  - Need High Probability Payment will be made
  - No performance offsets
  - Requires special government contract provisions





# Implications of Regulated IOU Financing

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- **Taxes**
  - Lump sum may be taxed as income in year received
- **Tradition - All Purchased Systems are Treated the Same**
  - Accounting, Operations, Service Restoration
  - Regulators are comfortable with utility system acquisition model
  - Government systems are small compared to utility system



# Implications of Regulated IOU Financing

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- **Difficult to Accommodate Third Party Financing Model**
  - Utility pricing formulas based on Cost of Service
  - Third party financing = no rate base
- **Service Restoration**
  - If privatized system is not absorbed in traditional manner, PUC may ask that utility to treat it below the line
  - Different service restoration priority for below the line customers?



# Summary

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- **Financed Amounts Are Relatively Small**
- **Taxes May Eliminate Interest Rate Benefit**
- **Altering The Historic Model Is Extremely Difficult**
  - Rate Making
    - Cost of Service Model is the Standard
    - Keep Accounting Simple
  - Regulatory
  - Operations
  - Service Restoration





# Contact Information

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